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Additional insights into how & when to use Level 2

● **Main Points:**

- As with any tool, Level 2 takes time to master. Hopefully, you've learned how to integrate chart patterns and Time & Sales into your trading with Level 2 in Module Two. Level 2 is used to time the exact second that you buy or sell a Nasdaq stock, after using market/sector strength, chart TA and Time & Sales. It's a timing tool, not a trend direction tool.
- We will cover a few more techniques you should be aware of in this final page, and will add new strategies they are developed.
- From screen layout to trading decision-making, there is much room for experimentation in coming up with the best Level 2 setup for your particular trading style. Continually refine and try new setups until you come up with one that works well for you.
- The dramatic recent increase in the use of level 2 trading means that there are many unskilled traders who buy and sell based on perceived level 2 support/resistance alone, which is incorrect (watch WCOM some day on L2 to see what I mean). However, we can capitalize on these trends by staying a step ahead of the crowd using T&S and charts to anticipate what newer traders will do using L2.
- Realize that you can make or lose a fortune with or without L2, it's a timing tool for active scalp traders who look to make roundtrip trades in under 20 minutes. Time and Sales is important to have, so it may be worthwhile to have an L2 provider for T&S access.

How and When to Use Level 2: More Tips

Examples:

TIP#1: Recognizing and acting on high-percentage vs. "indeterminate" market signals in Level 2

We've already covered the high-percentage plays you need to be effective in using Nasdaq Level 2; for example knowing the difference between an L2 box that shows no trend vs. one that shows buying or selling direction.

Pop Quiz:

Which of the two Level 2 boxes on the right should you buy stock for, all else being equal?

- NETA
- WCOM
- Neither

NETA		Best Market		P	T
NETA	-	23 1/2	b 23 1/2	a 23 9/16	10 x 20 1.38M 12:35
MMID	Bid	B...	MMID	Ask	A...
MLCO	23 1/2	10	ISLD	23 9/16	20
NITE	23 1/2	10	INCA	23 9/16	1
MADF	23 1/2	10	BTRD	23 11/16	5
REDI	23 1/2	4	BRUT	23 11/16	5
MASH	23 1/2	3	MSCO	23 3/4	10
OLDE	23 7/16	10	LEHM	23 3/4	1
MSCO	23 7/16	10	GSCO	23 7/8	10
SLKC	23 7/16	10	MFSC	23 7/8	1
BRUT	23 7/16	1	MONT	23 7/8	1
ISLD	23 3/8	10	FBCO	23 7/8	1
DEAN	23 3/8	5	HRZG	23 15/16	15

WCOM	Best Market	P	T	OK		
WCOM + 45 13/16 b 45 3/4 a 45 13/16 33 x 40 8.19M 11:08						
MM...	Bid	B...	MM...	Ask	A...	
REDI	45 3/4	33	INCA	45 13/16	40	45 13/16 100
ISLD	45 3/4	30	BTRD	45 13/16	30	45 3/4 600
INCA	45 3/4	20	MLCO	45 13/16	10	45 3/4 300
FCAP	45 3/4	8	MASH	45 13/16	10	45 3/4 9,000
LEGG	45 3/4	5	DLJP	45 13/16	10	45 3/4 200
						45 13/16 100
						45 13/16 100

d) Both

e) I don't know

FLTT	45 3/4	2	NITE	45 13/16	10	45 3/4	1.10K
MLCO	45 3/4	1	GSCO	45 13/16	10	45 3/4	200
DLJP	45 3/4	1	NFSC	45 13/16	7	45 3/4	1.00K
DBKS	45 3/4	1	AGED	45 13/16	5	45 13/16	100
SHWD	45 3/4	1	REDI	45 13/16	3	45 3/4	1.00K
JEFF	45 3/4	1	MONT	45 13/16	1	45 3/4	1.40K
MSCO	45 11/16	10	SLKC	45 7/8	10	45 13/16	1.00K

answer: a) since there's not as many sellers as buyers And T&S is slightly biased to the buy side

The point is: don't buy or sell stock based on L2 alone, particularly if it shows an "indeterminate" pattern like the WCOM box to the right. Use T&S and chart TA to determine stock trend and entry/exit points, not L2.

In the WCOM example, now, if it had just tanked from 51 to 45 1/2, and was starting to get buyers back, then maybe I'd enter a long position for the bottom bounce. The L2 alone isn't enough. T&S is king, followed by 1-minute chart technical analysis patterns.

Tip #2: Making the Market for a living Using Level 2

Chris Farrell's rather uninspired "daytrade online" book goes into this method for listed / NYSE stocks; I wouldn't try to make the market the way he describes - fortunately, our L2 does become much more valuable for this type of trading.

It's simple: find a stock that's trading in a channel (usually happens during lunchtime; though these are typically times where a stock weakens as well) - and enter a limit buy order at the current bid (either the inside bid or 1-2 levels outside), after you get filled then immediately offer it out at the ask.

This works only if you're trading 500-1K or more shares at a time; since your profit on teenies (1/16ths) is only \$62/1000. I try to scalp 1/8ths, which is \$125 per round turn per 1K shares. The key is to find a relatively liquid stock that's trading flat, using L2 and T&S to time your bids and asks.

This does Not work, of course, if you trade like new traders do, buying at the ask and selling at the bid, you're giving up 2 spreads this way, which is unprofitable. The only time you pay retail is if the stock is moving quickly and you want to exit fast - the retail exit is the fastest way to go.

Also play around with different order routing strategies in this type of trading, eg limit buy SOESing a mm or selectnet preferencing to see if you can get a price improvement. It's "fishing by selectnet" so to speak.

Most of the time, though, I'll just bid for stock at the inside bid (or 1/32nd higher if T&S is bullish), and then offer out at the ask immediately (or 1/32nd lower if T&S is bearish). These roundtrips should take no longer than 5-10 minutes maximum. Unless, of course, the stock is quickly headed up and you want to ride the momentum for a larger gain.

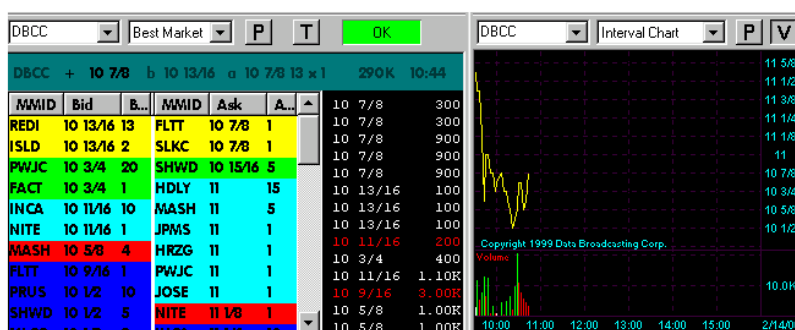
Tip #3: Using L2 to trade Stocks in Motion

Stocks that are rapidly rebounding off a low (or making new highs via a breakout) are the two best plays to make.

Let's look at how L2 can help us recognize and make these trades successfully.

In this DBCC bounce, we see the low was at 10 1/2 (remember large fractions, the 1/4s, 1/2s and 3/4s) are typical pivot points for under-\$40 stocks in general.

We see lots of trades going off at 10 7/8, which is bullish. If I had entered at the 5/8 or so, I'd offer my stock out at 10 15/16.



Why? There's a lot of sellers at 11, so I want to be a teeny ahead of them, so I can exit my position. If the stock runs through 11, which is unlikely, I can always buy it again at 11 1/16th or so.

This is an excellent "unknown tip" to follow: if you're long a position, sell right before it hits the whole number resistance.

If you're right and it falls back, great, you got the max profit out of the deal. If you're wrong and buyers continue, you can always buy the stock back at a teeny or an eighth over the whole number. This is a great way to give yourself insurance in a trade. I seldom try to hold an under-\$40 stock through a whole number price level unless T&S is solid green and it's "running", I'll sell into the whole number buyers, and wait to see if the crowd pushes it higher. Sometimes they do, sometimes they don't. I want to "sit out" all low-percentage plays, and punching through whole numbers is low percentage. Particularly decade or fives, eg 20, 25, 30. Wall of bricks, since there's a lot of market stops/sell orders lined up at these whole number price levels.

The reverse is true for entering a position on a bottom bounce, eg if it's tanking from 29 to 27 1/8, you might want to buy at 27 1/8 and use 26 15/16 as your stop. This is a high-percentage play that L2 can help you with.

Level 2 helps you to see these walls of support and resistance. Bounce scalps off them to profit.

More tips will be added in time; keep checking back as new momentum plays are developed and posted